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News release

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The Financing of Technology-Based Small Firms

The Bank of England today launched a report, "Financing of Technology-Based Small Firms", examining changes in the financing environment for technology-based small firms (TBSFs) since its previous report on the subject in 1996. The report was launched at a dinner in Edinburgh, hosted by Alastair Clark (Executive Director, Financial Stability) in conjunction with the Bank's Agency for Scotland.

The report suggests that many TBSFs have a number of characteristics which distinguish them from the generality of the small business population, and which might affect their ability to raise external finance. These features include: a lack of tangible assets and track record; the need for long-term investment; and growth potential which relies on necessarily unpredictable success in the exploitation of new science or technology.

The report notes that, while banks do lend to small high technology businesses, many such businesses are better suited to equity finance. Efficient public equity markets are important to a flourishing high-technology sector, although the small size and lack of trading record of many TBSFs precludes them from meeting the criteria for public listing. Private equity, therefore, plays a crucial role in the financing of TBSFs.

The UK private equity industry is the largest and the most developed in Europe, and invested nearly £8 billion in 1999. Just over £1 billion went to UK high-technology companies, but only £235 million was allocated to start-up and early stage TBSFs. The report, drawing on a series of meetings with fund managers, examines the attitude of institutional investors to private equity in general and to TBSFs. It highlights a number of factors, including the regulatory environment, that affect investment decisions, but, unsurprisingly, concludes that the most important consideration is the risk/reward relationship. Research suggests that long-run risk-adjusted returns on both early-stage and high technology UK funds have fallen below investors' targets, and below returns to private equity overall. More recent data indicate, however, that the absolute and relative performance of UK early-stage and technology funds have improved significantly over the past six to seven years.

The report concludes that, while some TBSFs in the UK do experience difficulties in accessing risk capital at seed, start-up and early stages, there is no clear evidence that these difficulties are now any greater than for

small firms in general. While there may still be market weaknesses in the provision of relatively small amounts of risk capital in the UK, these appear to be less than four or five years ago, and to have less impact on TBSFs. The overall position of TBSFs may nevertheless be more difficult than for the generality of small firms, because debt finance is usually not an available or appropriate alternative means of funding.

A number of factors have contributed to this improved environment: better realised returns in recent years; fiscal incentives; some shift in institutional investor attitudes; and the increasing availability of alternative sources of finance through business angels and corporate venturing. The Government has also introduced a number of measures in support of high-technology projects.

The report makes two specific recommendations. First, more research needs to be conducted on the role of business angels in the provision of finance to TBSFs, with as a first step the collection of better statistics and information on the UK business angel market. Second, more could be done to assist start-up and early stage TBSFs to become "investment ready" and therefore better able to understand the expectations and requirements of investors. This could involve both public and private sector organisations, including the Small Business Service and the British Venture Capital Association.

The Bank will continue to take a close interest in the financing environment for TBSFs in the UK, and to report on its work.

Note for Editors

Copies of the Financing of Technology-Based Small Firms report are available from the Public Enquiries Group, Bank of England, EC2R 8AH (Tel: 020 7601 4012; Fax 020 7601 5460) or from the Bank's website.

Key Resources

Financing of Technology-Based Small Firms

<http://webarchive.nationalarchives.gov.uk/20100114080129/http://www.bankofengland.co.uk/publications/financeforsmallfirms/hightech2001.pdf>